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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

COPY

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Ex Parte Presentation in CC Docket Nos. 96-98 and 99-68

Dear Ms. Salas:

CompTel and ALTS would like to supplement our analysis regarding the concept that the Commission's pending decision in the above-captioned proceeding would contain a "growth ceiling." ALTS and CompTel explained the likely effects of such a growth ceiling on competitive carriers in our joint *ex parte* letter dated March 26, 2001.[1] However, we did not attempt to address the collateral effects of the "growth ceiling" aspect of a hypothetical transition plan in our previous submission. Such a feature would ensure that ISPs, and other customers with large net volumes of terminating traffic, would likely face a noticeably less competitive market for a critical input. In fact, the growth ceiling would likely transform what is currently a vigorously competitive market for ISPs into an efficient cartel with respect to these same customers.

Starting with the fact that there are certain non-zero incremental costs associated with the transport and termination of ISP-bound dial-up traffic, it is easy to illustrate how the "growth ceiling" likely will result in an increase in prices to both ISPs and retail Internet access service users. So, for the sake of illustration, let us assume that the cost of the most efficient carriers (ILEC or CLEC) to carry and deliver an ISP-bound call is .275 cents/minute. The incumbent LEC, which is a market share leader in terms of providing service to ISPs and which also owns its own retail ISP, will realize an immediate benefit by raising prices to its ISP customers by imposing a .27 cents/minute surcharge on all of their traffic. These ISPs will, no doubt, seek to avoid this surcharge by requesting service from a competitive carrier. The competitive provider, however, will have no incentive, or ability, to offer a better price to the ISP without losing money on each minute it terminates. Because serving an additional ISP would cause any competitive carrier (currently serving ISP customers) to exceed the growth ceiling, any minutes in excess of the "growth ceiling" would, assuming the competitor is still charging its "pre-growth ceiling" rates, need to be carried for free. So, it follows that the best price an efficient carrier could provide any "new" ISP customer, assuming that the efficient competitor also had excess network capacity, would be at a rate of .275 cents/minute in addition to its current prices. Thus, any CLEC that fails to follow the lead of the price leader would

[1] Letter from John Windhausen, ALTS, and H. Russell Frisby, Jr., CompTel, to Dorothy Attwood, Chief, Common Carrier Bureau, CC Docket Nos. 96-98 and 99-68, dated March 26, 2001 [March 26 Ex Parte].

be automatically "punished" by simple operation of the Commission's rule.[2] In this way, the proposed "growth ceiling" would become the most effective tool for ensuring the efficient administration of a cartel, because the Commission's policy, itself, would result in the immediate, and automatic, discipline of any carrier that might be tempted to deviate from the group pricing dynamic.

In our example, we assumed that the vertically-integrated ILEC (operating as both a retail ISP and a supplier of telecommunications inputs to non-affiliated ISPs) would be the natural price leader, because the ILEC probably has a substantial share of the ISP telecommunications input market as well as a significant share of the "downstream" retail market for Internet access. Thus, the ILEC would realize multiple benefits by increasing its prices immediately by the amount equal to the costs of an efficient competitor. The ILEC, as an input supplier, would see an immediate increase in its revenues from its ISP customers, who, as we explained earlier, would realize no economic benefit by switching to a competitor. In fact, as we also explained, all ISPs would see an immediate increase in their prices, because competitive providers necessarily would follow the price increase of the leader, or risk having to terminate huge volumes of traffic below cost. Hence, the ILEC, as a retail provider of Internet access, now could also profitably increase its rates to its end-users and be reasonably certain that its competitors will follow suit. If its retail competitors fail to cooperate by raising their retail rates, the ILEC could be reasonably certain that these providers would see a corresponding increase in their costs from competitors, which would begin charging for the traffic in excess of the growth ceiling.

For the reasons CompTel and ALTS explained in our March 26 *ex parte*[3], a unilateral price increase to ISPs likely would not be defeated by new entry, as the growth ceiling operates as a *de facto* bar to entry at pre-existing prices. Similarly, based on numerous discussions with our collective members, who represent the vast majority of competitive providers of local exchange service to ISPs, ALTS and CompTel do not believe that, at this early stage of local exchange competition, there exists a sufficient level of capacity, not subject to a growth ceiling in some fashion, to render unprofitable a unilateral price increase by the ILEC.

Indeed, the leading government competition authorities recognize the competitive harms that can result when circumstances exist that "may permit a single firm, not a monopolist, to exercise market power through unilateral or non-coordinated conduct—conduct the success of which does not rely on the concurrence of other firms in the market or on coordinated responses by those firms."[4] The resulting public policy harm "is a transfer of wealth from buyers to sellers or a misallocation of resources."[5]

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[2] In our example, even the most efficient competitors would lose .005 cents/minute (.275 cents/minute minus .27 cents/minute) one each new minute of ISP-bound traffic.

[3] March 26 *Ex Parte* at 3.

[4] Horizontal Merger Guidelines of the U.S. Department of Justice and the Federal Trade Commission, issued April 2, 1992, revised April 8, 1997 at Section 0.1. ["*Merger Guidelines*"]

[5] *Id.*

The *Merger Guidelines*, in discussing circumstances in which firms may be able to unilaterally, and profitably, restrict output and raise prices, specifically contemplate situations where the other market participants cannot increase their own output in order to offset the price increase of the unilateral actor. After noting the potential for a unilateral price increase, the Merger Guidelines go on to note that,

> "[t]his unilateral effect is unlikely unless a sufficiently large number of the merged firm's customers would not be able to find economical alternative sources of supply, i.e., competitors of the merged firm likely would not respond to the price increase and output reduction by the merged firm with increases in their own outputs sufficient in the aggregate to make the unilateral action of the merged firm unprofitable. Such non-party expansion is unlikely if those firms face binding capacity constraints . . ."[6]

The resulting constraints on the market resulting from the 10% growth ceiling would be no different from those which, if they resulted from a private merger agreement, the government would condemn as anticompetitive. So, it is quite obvious that the ILECs will receive substantial benefits from a prospective growth ceiling, well in excess of whatever justification was claimed to support such an anticompetitive feature. However, the Commission must consider whether the ILEC's feigned concern over escalating volumes of dial-up ISP-bound traffic is worth sacrificing the benefits of the law to an important sector of the information economy. Thus, CompTel and ALTS urge the Commission to reject completely the self-serving and duplicitous request of the ILECs for a "growth ceiling" that would do nothing more than provide a ceiling, and a low one at that, on both wholesale and retail Internet competition.

Sincerely,

John D. Windhausen, Jr. /CAG
John D. Windhausen, Jr.
President, ALTS

H. Russell Frisby, Jr. /CAG
H. Russell Frisby, Jr.
President, CompTel

cc: D. Attwood
K. Dixon
G. Reynolds
T. Preiss
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[6] *Merger Guidelines*, Section 2.22.